Discussion of Afonso, Cipriani, La Spada (2024) "Banks' Balance Sheet Costs, Monetary Policy, and the ON RRP"

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Background: ON RRP and SLR

- When the Fed conducts QE operations, it has to fund the purchases
- ... which is typically done by issuing reserves to eligible banks

- In the past, QE operations led to a large increase in the size of banks' balance sheets
- ... because banks didn't just trade securities for reserves,
- ... but other agents ended up selling securities, leading to more bank deposits

- The balance sheet expansion becomes an issue if banks face leverage constraints
- **SLR** provides such a constraint and was therefore temporarily paused in 2020/21, when the Fed revamped its QE-program following the COVID-19 outbreak

- **ON RRP**: form of reserves for nonbanks & broadens the set of creditors to the Fed

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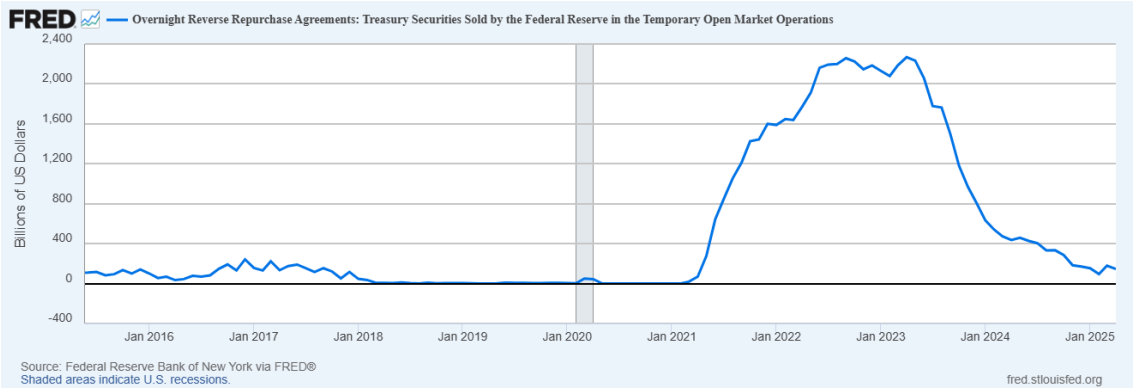
Key Results

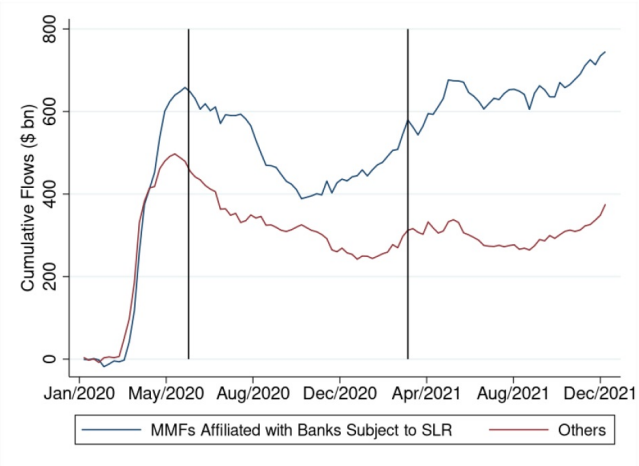
Key Results (1)

- Reimplementation of SLR early 2021 led to a large increase in ON RRP usage



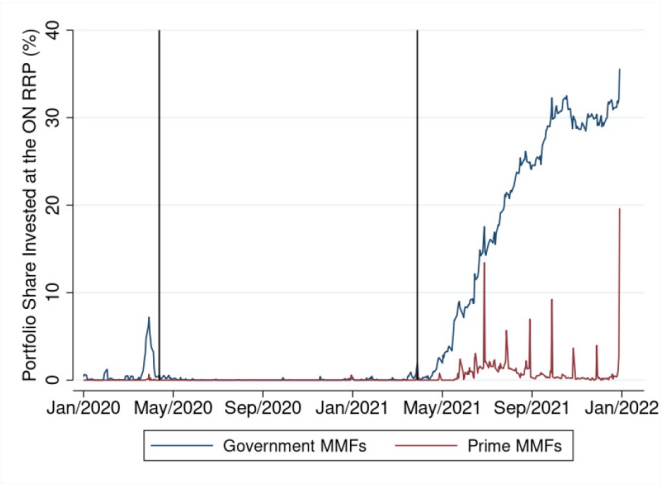
Key Results (2)

- MMFs affiliated with banks subject to SLR experienced larger inflows



Key Results (3)

- Government funds switch to ON RRP when repos by banks decline



Comments & Suggestions

Comment I: Interpretation of Findings (1)

- **Abstract**: "Our results imply that when non-banks can access the central-bank balance sheet, they end up holding a share of central-bank liabilities, draining reserves and attenuating the impact of QE."
- **Intro**: "Moreover, if the goal of the Federal Reserve balance-sheet expansions is to stimulate the real economy through QE, an increase in ON RRP take-up due to banks' regulatory constraints stunts the central bank's ability to do so: as the Federal Reserve injects liquidity into the economy by purchasing assets in the open markets, this liquidity ends up invested with the Federal Reserve itself through the MMF industry, rather than supporting private credit and investment."
- **My interpretation**: The existence of the ON RRP makes it easier to implement QE since not only the banking sector serves as a creditor to the Fed with its potential limits on how many reserves it can absorb due to leverage constraints but a broader set of financial institutions
- If the banking sector has to absorb a large amount of reserves, this may hinder bank lending (Diamond, Ma, Jiang, 2024; Koont & Walz, 2024)

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- If the banking sector has to absorb a large amount of reserves, this may hinder bank lending $\rightarrow$ lower quantity of lending
- **BUT**: Limiting the set of Fed creditors to banks via reserves + imposing leverage constraints on banks, may also imply a stronger price impact on securities when conducting QE, these stronger yield changes can pass through to borrowing rates $\rightarrow$ lower lending rates
- Which of the effects dominates is hard to say ("price vs. quantity")

  $\rightarrow$ Need more research on this question !

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Comment II: Deposit Movements

- ”MMFs affiliated with banks subject to the SLR experienced significantly larger inflows, as these banks had an incentive to shed depositors and push them into their affiliated funds.”
- Two thoughts on this point:
  1. Show these deposit flows in the data !
  2. This transfer implies a substantial loss of bank profits in a high interest rate environment since banks earn the deposit spread
     $\rightarrow$ Bank profits matter for bank lending, again an unwanted side effect of QE
     $\rightarrow$ MMFs pay rates to close to the policy rate, so their margin is substantially smaller

Summary

- Nice paper !
- **Some suggestions**:
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  2. Maybe add a model !
  3. Show deposit movements
  4. Study implications of those movements

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